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DDI-3648-82

30 April 1982

MEMORANDUM FOR: Executive Secretary [redacted] 25X1

VIA : Deputy Director for Intelligence

FROM : [redacted] 25X1
Director, European Analysis

SUBJECT : Versailles Paper on Impact of Oil Price Decline Prepared by Council of Economic Advisers

1. On 30 April, we provided Robert Murphy at CEA with our comments on his Versailles paper. We stated that the agency agreed with the basic conclusions of the paper--that a fall in oil prices would boost OECD GNP growth and reduce inflation and current account deficits. The impact of a 10-percent price decline on growth and inflation mentioned in the CEA paper are almost identical to results obtained with the use of our LINK model. However, we estimate that the improvement in OECD current account balance would be about double the amount cited in the CEA memo.

2. We indicated our agreement with CEA that among the major foreign industrial nations, Canada, France, Italy, and Japan might very well introduce measures to limit the decline in oil prices. However, we suggested that in the case of Canada, a reduction in oil prices would not only set back conservation efforts but also could reduce producer returns enough to jeopardize Ottawa's goal of energy self-sufficiency.

3. We also stated that our analysis supports the CEA's view that a decline in OPEC surpluses would not necessarily cause a reduction of world saving and subsequent rise in interest rates. In our recent oil price paper we suggested that a fall in oil prices would reduce budget deficits and, hence, lead to some easing in interest rates. The fall in interest rates coupled with the pickup in domestic demand would, in turn, motivate businessmen to increase their capital outlays. Moreover, the

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reduction in budgetary and payments deificts would provide central banks with greater flexibility to ease monetary policies, a step which would further enhance investment as well as private consumption.

4. A couple of minor corrections were passed on to CEA. First, Arab light is now going for $31.50 a barrel rather than $30 as cited in the CEA paper. Second, we suggested a change in wording--that the first criticism read "unless taxes on oil products are "<u>increased</u>" rather than "<u>adopted</u>"--since some countries already have taxes on oil products.

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